R E P O R T R E S U M E S

ED 017 990 EA 001 181

MONETARY POLICY AND THE FINANCING OF HIGHER EDUCATION.

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PUB DATE 67

EDRS PRICE MF-$0.25 HC-$0.84 19P.

DESCRIPTORS- #FINANCIAL POLICY, #EDUCATIONAL FINANCE, #HIGHER EDUCATION, #STUDENT LOAN PROGRAMS, #BANKING, FEDERAL PROGRAMS, EDUCATIONAL FACILITIES, FINANCIAL SERVICES, FONTANA,

COMMERCIAL BANKS ARE EXPECTED TO PLAY AN INCREASINGLY IMPORTANT ROLE IN THE EXTENSION OF CREDIT UNDER THE HIGHER EDUCATION ACT OF 1965, AND BANKERS' ASSOCIATIONS ARE ACTIVELY PARTICIPATING IN THE DEVELOPMENT OF THIS PROGRAM. HOWEVER, THE EXTENT OF COMMERCIAL BANK PARTICIPATION CANNOT BE ENTIRELY INSULATED FROM THE BROADER PROBLEMS ASSOCIATED WITH THE COST AND AVAILABILITY OF CREDIT TO ALL POTENTIAL BORROWERS, THAT IS TO SAY, FROM THE PROBLEMS RELATING TO THE FORMULATION AND EFFECTS OF MONETARY POLICY. THIS PAPER CONSIDERS HOW THE CREDIT DEMANDS RELATED TO HIGHER EDUCATION, AND IN PARTICULAR THE STUDENT LOAN PROGRAM, ARE RELATED TO MONETARY POLICY. BANKS HAVE TWO INVESTMENT ALTERNATIVES RELATIVE TO STUDENT LOANS--THEIR OWN PLANS AND PARTICIPATION IN GUARANTEED LOAN PLANS. THESE PLANS AS WELL AS OTHER ASPECTS OF EDUCATIONAL FINANCE ARE DISCUSSED IN TERMS OF THE AVAILABILITY OF MONEY AS DICTATED BY FEDERAL RESERVE POLICY. THIS PAPER WAS PRESENTED AT THE COLLEGE SCHOLARSHIP SERVICE COLLOQUIUM ON FINANCIAL AID (3D, FONTANA, WISCONSIN, MAY 22-25, 1966) AND THE COMPLETE DOCUMENT, OF WHICH THIS IS ONE PAPER, "THE ECONOMICS OF HIGHER EDUCATION," IS AVAILABLE FOR $2.00 FROM THE COLLEGE ENTRANCE EXAMINATION BOARD, PUBLICATIONS ORDER OFFICE, BOX 592, PRINCETON, NEW JERSEY 08540. (HW)

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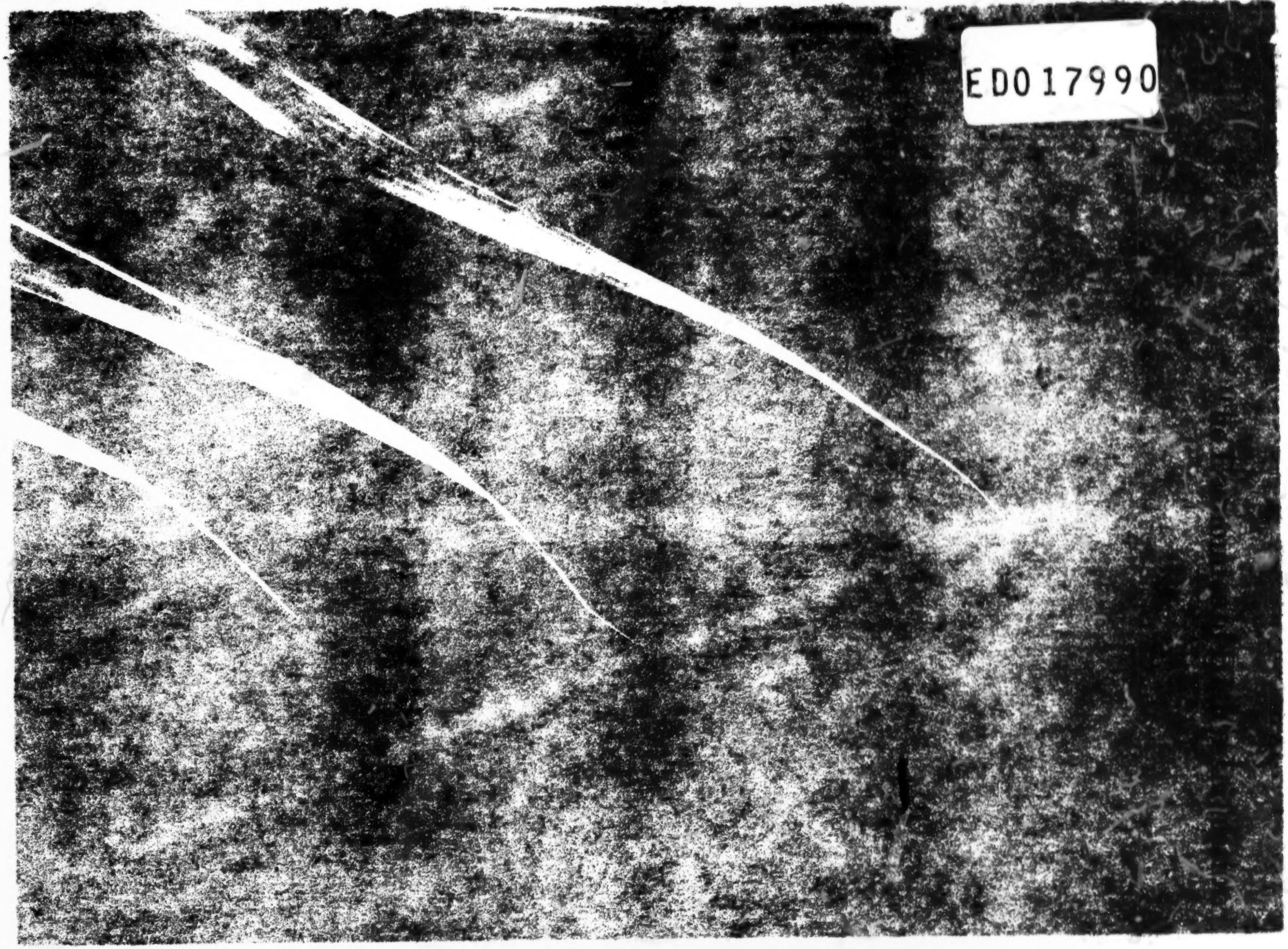

The Economics of Higher Education

Papers Presented at the Third College Scholarship Service Colloquium on Financial Aid, May 22–25, 1960, Held at The Abbey on Lake Geneva, Fontana, Wisconsin

U.S. DEPARTMENT OF HEALTH, EDUCATION & WELFARE
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College Entrance Examination Board
New York, 1967

Additional copies of this book may be ordered from College Entrance Examination Board, Publications Order Office, Box 592, Princeton, New Jersey 08540. The price is $2 per copy.

Editorial inquiries regarding this book should be addressed to Editorial Office, College Entrance Examination Board, 475 Riverside Drive, New York, New York 10027.

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Library of Congress Catalog Card No.: 67-27896

Printed in the United States of America

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Foreword

In 1962 the College Scholarship Service held its first colloquium on student aid. Because of the long-standing concern of the CSS about gaining the maximum effect from a given amount of aid available, the CSS planned and conducted that Colloquium during both sessions of the Eighty-Seventh Congress. At that time aid to education bills, including a federal scholarship bill, were pending before Congress, but it was just before the time in America's history when Americans and the Congress were ready to back up the goal of equal access to higher education—not only with money, but, more important, with the moral support and commitment reflected in the dollar support.

In 1962 the federal government was in the student aid field primarily through the National Defense Student Loan Program. Since that program was enacted in 1958 as part of the defense-focused reaction to the new space age, federal appropriations for it have grown from an initial $57 million in 1959–60 to more than $190 million. The Congress added a work program in 1964 as part of the Economic Opportunity Act and, finally, a grant program under the Higher Education Act of 1965 to complete the three-part federal program of student aid at the undergraduate level. These new programs have already added $200 million annually to the available resources for financial aid. When they are fully operative in 1969–70, they will contribute approximately $400 million and bring the total federal support for these three programs to almost $600 million.

State governments have entered the student aid field in an accelerated fashion over the past 10 years; 17 states now have competitive scholarship programs open to candidates, without restriction as to field of study. Of these 17 programs, all but New York's have been established since 1956 (New York enacted the first program of this kind in 1913—the New York State Regents College Scholarship Program). And 9 of the 17 state programs have been established since 1963. Under these 17 programs, more than $100 million is available annually to roughly 300,000 students. When these funds are added to the $600 million from the three federal programs, the public share of the total student budget for college attendance will be greatly in excess of what it was five or even three years ago. In addition, the potential of the permanent GI Bill adds substantial funds, possibly $400 million a year, to these figures, depending on the extent to which veterans avail themselves of this opportunity.

Concurrent with this significant increase in public responsibility for student expenses, a number of other trends have been noticeable. First, and most important, the number and the percentage of students enrolled in public institutions of higher education have increased markedly, in comparison with enrollment in private institutions of higher education. In 1959–60, for example, enrollments were 1,474,000 in private and 2,136,000 in public colleges and universities. In 1964–65, the respective numbers were 1,916,000 and 3,655,000. This trend shows no sign of reversal and leads to some major questions about national policy.

It was in this context that the College Scholarship Service decided in 1965 to hold its third colloquium on the topic, "The Economics of Higher Education." The concern of this Colloquium, and an ongoing concern of

the 860 institutions that make up the membership of the College Scholarship Service Assembly is the pattern for the financing of higher education, including the pattern of attendance. To what degree are the problems of cost and facilities solved by the increasing pattern of public attendance—especially attendance in community colleges free of the financial burdens of construction, housing facilities, and housing fees to students? Even if the growth of these institutions solves certain financial problems, what is the cost in diversity, in student choice, and in the role of the private institution?

Even if some agreement can be reached in national policy about the respective roles of private and public institutions, what patterns can be agreed upon for the cost of college attendance to students? What percentage of the total institutional cost should the student bear in public institutions as well as in private institutions? What level of cost differential between the private and public institutions will the general public support? How high can the cost for the undergraduate years, grades 13 to 16, be set in a society that heavily subsidizes all other levels of education? If more public support were to be made available to private institutions, how can their independence be preserved?

These are difficult questions that must be faced and answered as America passes into the last third of the twentieth century. And this Colloquium was planned and held in an effort to help national thinking in finding the answers to some of these questions. It is the hope of those who planned the Colloquium that the published papers will stimulate some thinking about these key questions.

I want to take this opportunity to thank James L. Bowman for his work in directing the Colloquium. At the time of the Colloquium, Mr. Bowman was director of financial aid at Johns Hopkins University. He is now associate program director of the College Scholarship Service at Educational Testing Service, Princeton, New Jersey. I also want to thank the 12 speakers who, through their papers and in discussions, contributed much to this ongoing debate. The CSS hopes that these papers will prove valuable to the groups and commissions that have been established to study the structure of higher education in this country.

GRAHAM R. TAYLOR
Associate Director
College Scholarship Service

May 1967

Introduction

Reflecting on the Colloquium at which the papers in this volume were presented, I am reminded of a passage from Lewis Carroll's great children's classic:

" 'Will you tell me which way I ought to go from here?'
'Depends on where you want to get to,' replied the Cheshire cat.
'Well, I really don't very much care,' replied Alice.
'Then, it doesn't matter much which way you go,' said the cat."

For when looking at an area as broad as "The Economics of Higher Education," one can very readily feel like Alice. However, with the assistance of a very able advisory committee, the Colloquium planners were able to ascertain where they intended to go.

As envisaged by the planners of the meeting, the Colloquium was intended to deal broadly with the question of the most effective methods of financing higher education, and with the role and problems of the educational consumer. It was hoped that the Colloquium program would provide a guide to the problems, both present and implied, in current trends of financing higher education and would raise questions regarding the future that the participants could carry back to their own institutions. The role of the speakers, then, was not to present the results of research, but to present and discuss stimulating issues and assist the financial aid officers in looking at some of the implications for the future. That the speakers succeeded in this endeavor I think there can be little doubt.

I will not try to summarize the papers that were presented at the Colloquium and that now appear in this volume. To do so would not do justice to the presentations, for what one person views as important may be entirely irrelevant to another. It may be helpful, however, to review the framework of the program in which the papers were presented.

The initial address "Broadening the Socioeconomic Base of Higher Education in an Era of Rising Costs," by the Honorable Peter H. Dominick, Senator from Colorado, and the paper by Professor Seymour Harris on the economics of higher education, provided for discussions in the relatively broad area of the economic problems of higher education.

From this broad overview there followed discussion of the ways higher education can be financed, in view of the continued rise in the cost of education and society's desire to make higher education more accessible.

Of great concern, with respect to student accessibility to higher education, is the pricing problem of higher education and its concomitant effects on institutions, student choice, and the socioeconomic mix of the student body. It is to this area that the papers presented by Allan Cartter and Fred Glimp were directed. As pointed out in the discussions that followed these papers, some source of funds other than parental income and college endowment must be used if access to higher education is to be broadened.

Given the fact that the resources of society must be used in the support of higher education if accessibility is to be broadened, what is the rationale for society's investment? Economists and sociologists have long been interested in the economic and social returns to the individual and to society that result from investment in higher education. There is

little doubt that there is some return from this kind of investment, and this reason is often advanced in support of proposals to rely upon long-term credit to the individual as the means of financing higher education. It was within this framework that Lee Hansen presented his paper. He left the thought with the Colloquium participants that, while there is a return to society and the individual, reliance on quantitative figures may be misleading, for there is much more work to be done in this area.

From the discussion of the rationale for society's investment, the participants progressed to discussions of the actual investment that is taking place within the public sector in the support of higher education and the broadening of accessibility to higher education. At the same time, alternative measures and future implications must also be of concern.

The United States government has long been a major provider of funds in support of education at all levels. Historically, the support has been directed toward the institutions in terms of grants, appropriations, tax support, and a host of other means. With the growing emphasis on accessibility to higher education for more of America's youth has come an increasing support of programs devoted to student financial aid. The interest of the federal government in educational opportunity was viewed by Peter Muirhead of the Office of Education in his discussion of federal financial aid programs. Within the area of state and local support of higher education, Selma Mushkin raised many questions for the future by projecting the need for expenditures in the decade ahead and the requirements that this expenditure will impose on the financial structure of state and local governments.

While current support of higher education by government is higher than ever before, a feeling exists that much more support is needed. An alternative solution that has been proposed, in lieu of increased direct federal support, is the provision of tax credits for educational expenditures. The pros and cons of such an approach to educational financing and its implications for the future are the target of the papers presented by Roger Freeman and Edwin Young. That the subject proved interesting to the Colloquium participants was demonstrated by the fact that the question and answer period continued long past the normal hour for adjournment.

The final phase of the Colloquium was devoted to some implications for the future in existing student financial aid programs. The growing proliferation of long-term credit for student financing of higher education has become of increasing concern to financial aid officers, and to institutions of higher education. As students continue to make substantial investments in current education from future repayments, what are the implications with respect to individual students and the institutions? In his paper relating to this area, Jack Critchfield gives financial aid officers great food for thought. Although concern has been expressed over the proliferation of loan funds, the judicious use of loans, in combination with other forms of financial assistance, is firmly entrenched in the student financial aid program. Consequently, the availability of funds for the purposes of long-term student credit is of importance. With increasing emphasis being placed on the commercial banking systems as the provider of funds for student credit, the effect of monetary policy on the ability of the banks to make loans is of great interest to financial aid officers. Many implications for the future were presented by Eliot Swan in his discussion of monetary policy and its effects on the financing of higher education.

An area of concern to institutions of higher education and to student financial aid officers is the effect on private philanthropy of the expanding role of government in the provision of student financial aid. The discussion by Robert Kreidler within the framework of support to higher education provided great insight.

While this summary has briefly sketched the framework of the Colloquium and the individual papers collected in this book, there is no way to reflect the discussions and interchanges, in both formal and informal settings, that took place among the participants in the Colloquium. That those who came were interested was evidenced by the fact that there was full attendance at all the sessions, in spite of the many diversions offered by the meeting place.

As director of the Colloquium, I would be remiss if I did not express my appreciation to the speakers for their excellent presentations, to the participants for their warmth and responsiveness, and to the staff of the College Scholarship Service for attending, in such a competent way, to the myriad of administrative details that are involved in such a meeting.

JAMES L. BOWMAN
Director of the Colloquium

April 1967

Monetary policy and the financing of higher education

by ELIOT J. SWAN

Let us live in as small a circle as we will. We are either debtors or creditors before we have had time to look around.

Goethe (1749–1832)

Goethe was not referring to educational financing in general, nor to student loans in particular. Yet the increasing attention being directed toward credit as a source of funds for institutions of higher education and their students is of vast importance. I am not an expert on the financial problems of higher education, past, present, or future, but I greatly admire the patience, perseverance, and imagination with which these problems are pursued by financial aid officers whether with legislatures or parents or alumni.

Commercial banks are expected to play an increasingly important role in the extension of credit under the Higher Education Act of 1965, and bankers' associations are actively participating in the development of this program. However, the extent of commercial bank participation cannot be entirely insulated from the broader problems associated with the cost and availability of credit to all potential borrowers – that is to say, from the considerations relating to the formulation and effects of monetary policy.

Monetary policy bears directly upon commercial banks. In order, therefore, to appraise the impact of monetary policy on the financing of higher education, one must first look to the banking system to see what roles – direct and indirect – are played by the banks in this country in supplying funds to colleges and universities.

As a supplier of long-term credit, and short-term credit as well, the banking system operates in a number of areas that are significant for the financing of higher education. Mortgages, for instance, though not usually considered when one speaks of educational financing, do serve as an important vehicle in meeting student expenses. Mortgage refinancing is said by some lenders to amount to between 25 and 35 percent of all mortgage extensions, and some of the funds raised in this fashion are used to meet college expenses. Last year the American Bankers Association estimated that outstanding home mortgage loans to finance college expenses amounted to perhaps $1 billion and were rising fast. In addition, banks make direct personal installment loans, usually to parents, for the same purpose. Many banks are already participating in state and private guaranteed student loan arrangements.

Banks have nearly doubled their holdings of "municipal" securities since 1961. This has a very direct bearing on higher education. Since 1961 there has been a sharp increase in the flotation of state and local securities for education, other than elementary and secondary school education. In 1961, sales of new securities for "other education" amounted to 6.3 percent of total securities for educational purposes and 2.1 percent of all tax-exempt issues. By 1965, new securities for "other education" accounted for 22.5 percent of all educational bonds sold and 7.6 percent of all new tax-exempt securities sold during the year. Obviously, the banking system played a significant part in the provision of funds for public college plant and equipment outlays in this four-year period.

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Thus, it is apparent that the banking system is active in certain areas of longer term credit now affecting the financing of higher education in one manner or another. Currently, there is a great deal of commercial bank interest in, and discussion about, the guaranteed student loan program authorized in the Higher Education Act of 1965. In addition, there is now pending legislation which would extend the sale to private lenders, including banks, of participations in assets held by federal agencies to include higher education academic facilities loans.

Principal attention currently, however, is being directed to commercial bank participation in student loans. Incidentally, many credit unions, savings and loan associations, and mutual savings banks have authority to make loans for educational purposes. While these institutions should be encouraged to, and in all probability will, expand their efforts in this area, commercial banks undoubtedly will be looked to to provide the major share of funds for student loans under the new programs as they have in the past.

The American Bankers Association and the Association of Reserve City Bankers have indicated strong support of the student loan program. At their annual meeting in April 1966, the Reserve City Bankers made explicit four assumptions concerning student loans:

"1. Banks will be the major source of lendable funds.

"2. All banks will eventually participate in the program and allocate funds to make these loans.

"3. Students will borrow primarily in their hometowns rather than in their college towns.

"4. Less than one-half of the states have qualified guaranteed loan programs in operation, and there will be a lag once programs are approved and the first loans are made."

On this basis the Association of Reserve City Bankers adopted the following resolution:

That the association:

"1. Take the initiative in making loans under the state and private programs as they are established, and strive for 100 percent participation among all other banks, and

"2. Cooperate with A. B. A. and the U. S. Office of Education in providing its members and correspondents with information regarding the new legislation and the existing state and private programs, and

"3. Take an active part in establishing guaranteed loan programs in their respective states, and in developing methods and procedures for providing adequate amounts of funds in all sections of the country."

The Executive Council of The American Bankers Association, at its spring meeting in late April 1966, adopted the following resolution:

"*Whereas* the Higher Education Act of 1965 placed the responsibility for guaranteed student loans in the hands of state and private student guarantee programs, and

"*Whereas* the banking industry played a major role in getting a Federal student loan guarantee program placed on a stand-by basis, and

"*Whereas* the program as it now stands gives the banking industry a new opportunity to show that the private sector can be effective in meeting a pressing public need, and

"*Whereas* the United States Office of Education has devoted extensive efforts to develop workable state and private programs and to make sure these programs do not impose needless and costly administrative or operational burdens on private lenders, and

"*Whereas* the Association of Reserve City Bankers has pledged its full cooperation with the A. B. A. and the U. S. Office of Education in promoting state and private guarantee programs and has also pledged its efforts to devise methods and procedures for providing adequate amounts of funds in all sections of the country, and

"*Whereas* the success of student loan programs depends upon the active participation of all of the nation's banks:

"*Now, therefore, be it resolved* that The American Bankers Association encourage all member banks to take the following actions:

"1. Assign a member of top management, with the approval of the board of directors, the task of formulating and implementing the bank's policy and program to meet local demand for student loans.

"2. Take an active role in assuring that each state has adequate insurance reserves provided through either a state or private, nonprofit loan insurance agency.

"3. Utilize the correspondent banking system to see that demand for student loans is being met adequately in every community in the nation."

Charls Walker, the executive secretary of The American Bankers Association, recently told the House Special Subcommittee on Education: "I fully anticipate that the promotional, educational, and informational activities connected with our support of the guaranteed loan program will prove to be one of the largest public relations campaigns ever undertaken by The American Bankers Association."

I have no doubt that leaders in commercial banking, having persuaded Congress to utilize, strengthen, and expand state and private guaranty programs rather than adopt a program of direct federal insurance for student loans, intend to do their best to see that the program adopted is successful. There appears to be a genuine recognition of the public-service character of this undertaking.

At the same time, much will depend upon the way in which the program is developed and presented to the banking community. In California, where the necessary legislation for a state authority has just been passed, I understand there has been, and is continuing, close cooperation between the state and the California Bankers Association. However, banks that do not have extensive personal installment loan experience and facilities undoubtedly will need a good deal of guidance, advice, and encouragement from their associations.

It is difficult to arrive at firm estimates of the demand for student loans in the coming year, not to speak of the possible growth in the years ahead. It may be of interest, however, to note the dollar volume of activity of commercial banks in the installment loan area. At the end of 1965, commercial banks had outstanding $28 billion in installment credit, of which a little over $6 billion was in personal installment loans, as opposed to loans for the purchase of automobiles and other consumer goods and for repairs and modernization. During the year 1965, total installment credit increased by $4 billion, and personal installment loans by $800 million. This net change, of course, reflects extensions in 1965 of several times this amount, but it does indicate that a demand for student loans in the 1966–67 academic year of up to $700 million would be quite significant.

It is not my intention to try to spell out the magnitude or the desirability of the financial demands that higher education will be generating in the next few years. This task has been much more ably done by others, and for me to attempt it also would be like carrying books to Widener. What I shall do, however, is to consider how the credit demands related to higher education, and in particular the student loan program, are related to monetary policy.

At the outset, let me indicate that the Federal Reserve is certainly sympathetic toward the student loan programs currently being developed. In a letter to Commissioner of Education Harold Howe II, dated March 22, 1966, the chairman of the Board of Governors of the Federal Reserve System, William McChesney Martin, stated, with reference to the Higher Education Act and the National Vocational Student Loan Insurance Act:

"These Acts provide for insurance and guarantees of loans extended to students enrolled or accepted for enrollment in institutions of higher education and vocational schools. In

view of the insured status of such loans, you ask if it would be appropriate for the Federal Reserve System to consider such loans as preferential because less than normal risk is involved and payment of interest and principal is assured.

"When appraising the overall financial condition of any bank, examiners carefully analyze assets to determine the degree of risk existing in various types of loans, securities, and other assets in which the bank has invested. In evaluating the risk contained in the loan portfolio, examiners for the Federal Reserve System have been instructed to consider and accord proper weight to any insurance or guarantee provided by the U. S. Government, its agencies, or corporations established by it. Directives now outstanding to examiners, recognize that loans such as those insured or guaranteed by the Federal Housing Administration, the Veterans Administration, and the Small Business Administration, are in this special class and involve somewhat less risk than usual portfolio loans.

"The Board agrees that the aims of the Education Acts are most desirable, and it would not object to member banks extending loans insured or guaranteed under various provisions of the Acts. Examiners for the Federal Reserve System will be instructed to treat these loans in the same manner they treat other loans insured, either directly or indirectly, by the Federal Government. It has been the Board's experience that bankers are aware of the relatively riskless nature of loans insured or guaranteed by the U. S. Government, its agencies, or corporations established by it. Bankers are generally aware of the treatment accorded such loans by examiners, and I feel certain that any banker would weigh the desirable aspects of educational loans when deciding if such loans appeared appropriate for inclusion in the loan portfolio of a bank."

While Martin's letter refers primarily to federal guarantees, from a bank examination standpoint, whether it be the Federal Reserve or the other bank supervisory agencies, I believe that the advantages of insured or guaranteed loans in connection with student borrowing will be recognized, as indeed they have been in other types of publicly insured credit extensions. In this regard, the need to maintain state reserves at adequate levels is obvious. However, "preferential treatment" in terms of monetary policy is something else again.

Monetary policy consists of the decisions of the monetary authorities to make credit more or less readily available. These decisions are directed to influencing the operations of the financial system so that the nation may more readily achieve its economic goals of sustained growth in the economy, high employment of the labor force, price stability, and reasonable balance in international payments. The monetary authorities, in implementing these decisions, have no authority to single out any sector of the economy for special treatment, favorable or unfavorable. Monetary policy has general applicability across the spectrum of the economy. It is applied by a number of tools that bear upon the reserves of commercial banks, making it easier or harder for banks to expand their loans and investments. The behavior of commercial banks in response to the monetary policy actions of the authorities transmits the effects of these policies not only to their prospective borrowers but also in varying degree to all other financial institutions and credit markets. The Federal Reserve does not attempt to regulate bank lending by selecting specific types of loans that may be more or less desirable in terms of social objectives, nor does it have the power to do so. Neither does the Federal Reserve require that banks move into or out of securities, or indicate specifically how banks should meet the demands upon them for funds.

Monetary policy is popularly described in terms of being either "easier" or "tighter." An easier monetary policy means that the monetary authorities are supplying reserves to the

banking system relatively freely as a basis for an expansion of bank credit and the money supply. A tighter monetary policy indicates that the monetary authorities are supplying reserves at a reduced rate and thus putting pressure on the banks to limit the growth of bank credit. The easing of monetary policy is designed to promote economic recovery and to step up the rate of economic expansion, while tightening of monetary policy is calculated to slow the rate of growth in a boom, to check rising prices, and to prolong the period of prosperity. The ability of the monetary authorities to tighten money – to reduce the rate of borrowing and the rate of growth of expenditures – is very important to society. Without such controls, it is possible for the supply of money to be expanded much more rapidly than the supply of real resources in the economy. As the nation approaches full utilization of its resources, too rapid expansion of the money supply and bank credit would only lay the groundwork for price inflation.

When the Federal Reserve eases credit, individual commercial banks, finding themselves with more reserves for the expansion of loans and investments, must decide how they are to be employed, and to what extent they will reduce rates and liberalize their lending standards.

When the Federal Reserve tightens credit, individual commercial banks, finding themselves unable to accommodate all the would-be borrowers, must restrict the availability of their credit in one way or another, and they become more selective in the placement of their money. Relative profitability of different kinds of loans and investments is scrutinized along with other long-run banking considerations. In order to meet a higher proportion of loan demands, it may be decided not only to reduce the rate of purchases of new securities but also to sell some of the existing portfolio of federal and state and local bonds. Moreover, if good business loan requests from its long-established customers, for example, are very strong, the bank may be tempted to reduce the rate of expansion of other types of loans, or even to reduce the volume of outstandings of competing types of credits by allowing these credits to "run off" as they mature. In addition – in the case of mortgage loans, for example – it may be possible and desirable to sell packages of existing loans to other financial institutions, thus providing funds with which to meet heavier and more profitable demands elsewhere. Even within the area of business loans, the distribution of funds between working capital loans to carry inventories, for example, and term loans for financing somewhat longer investment projects, would depend partly on the relationship of immediate net yields and the current need for liquidity, and partly on longer term business and public relationships.

During periods of tight money, commercial banks find themselves under increasing pressure to obtain a liquidity that is fast being drained by loan-hungry borrowers. Although opportunities to make long-term loans continue to be present, banks are sometimes reluctant to lock themselves into an arrangement whereby the funds flow back from the loan only slowly as the borrower makes his repayments – unless, of course, bank management guesses that loan demand is going to decline fairly soon and that interest rates are currently about as high as they are going to get. Long-term credits that are not particularly remunerative in the existing market are not as likely to attract bank funds during a period of tight money, particularly if the "collateral benefits" of prospective future deposit and loan business are not promising.

To be sure, this situation could be relieved by a monetary policy designed to expand the reserves – and thereby the lending power – of commercial banks. And the Federal Reserve could, indeed, effect such an expansion. It is in just such instances, however, when tight money is reflecting tight productive capacity in the economy, that the well-being of the pub-

lic would be ill served by feeding an enlarged volume of borrowing. The spending of those additional funds would tend to push up prices, rather than to increase the output of goods and services. Under such circumstances, therefore, when in the public interest the monetary authorities are pursuing a policy of making money and credit conditions tighter, commercial banks have little alternative than to limit the availability and raise the cost of credit. And under these circumstances, some uses of funds, whether they are mortgages, municipal bonds, term loans to business, or whatever, would not be able to expand as they might otherwise do. Some borrowers will have to be disappointed.

Monetary policy is geared to general economic activity, and the banking system's ability and willingness to extend loans for educational purposes must be considered within the context of the general situation.

Some states for some time have had plans that guarantee all or a substantial part of the amount of student loans made by banks that participate in these plans, and additional states are entering this area under the Higher Education Act of 1965. United Student Aid Funds, Inc., a private, nonprofit organization, has been a pioneer in guaranteeing or endorsing loans made to students by participating banks. The repayment schedules of the plans vary somewhat, but they all have one thing in common: either a fixed or maximum interest rate payable on the loans. This ceiling rate is generally 6 percent.

If market rates rise above this ceiling rate, these loans become a less profitable investment alternative. The current prime rate—that is, the rate on business loans to borrowers with the highest credit rating—is 5½ percent. And, it might be noted, not many borrowers are getting funds at this rate. Also, banks are currently paying from 4 to 5½ percent on savings accounts and time certificates of deposit of corporations. Even abstracting from the costs of administering guaranteed student loans, there is not a great deal of margin at this time between the costs of additional time deposits to the banks and the ceiling rate of 6 percent on these loans. As I said earlier, immediate profitability is by no means the only factor involved in bank lending decisions, but it cannot be left out of consideration.

There is a certain amount of incompatibility involved in attempting to insulate a given market within the context of free markets in general. A precedent exists to the guaranteed student loan plan that should afford some insight into the problem. The Federal Housing Administration and Veterans Administration programs of guaranteed and insured mortgages have fixed or ceiling rates. These have have had the effect of inducing a cyclical pattern upon the extension of this particular form of mortgage credit. Even though the guaranty feature of this type of mortgage instrument gives it some preference in the market, when business activity is expanding and the demand for credit pushes up interest rates, the supply of funds going into these mortgages declines. Funds may be forthcoming only when the mortgage is discounted, raising the effective rate of interest. Housing authorities have recognized the effects of such a ceiling interest rate and have raised it on a number of occasions. When the statutory ceiling is exceeded, banks tend more strongly to concentrate their housing loans on conventional mortgages at higher rates.

The lesson seems plain enough for guaranteed student loans in which banks and other financial institutions are expected to participate. The market for student loans is not yet broad enough to have been tested conclusively in a period of tight money. It cannot be denied, however, that given the loan volume anticipated under a full-scale program, the alternative to lending to students under the guaranteed loan plans of placing these funds to more remunerative uses could have some effect upon the availability of funds for student loans.

About one-third of the commercial banks

in this country also have their own formalized educational loan plans. These plans have some distinctive features which set them apart from the guaranteed loan plans in which banks are also participating. Thus, situations could arise in which banks have two investment alternatives as far as student loans are concerned: their own plans and participation under guaranteed loan programs.

As a general rule, banks lend under their own plans to the parent or guardian of a student rather than to the student. This being the case, the financial capacity of the student's family is an important consideration. Second, the repayment period under this type of loan starts immediately after the loan is made, rather than some time after the student ceases to be a student. Hence, the repayment period is shorter. Finally, the interest rate is higher: 6 percent and above. It might be noted that 6 percent tends to represent the "floor" for these loans, whereas it represents the "ceiling" for the program of guaranteed loans.

Such bank plans for direct student-parent loans are subject to the same general pressures emanating from tight money as have been described for other kinds of student loans. In this case, however, in contrast with the guaranteed loan program, the banks have generally retained sufficient flexibility to permit terms to rise with market conditions.

One feature of the Higher Education Act of 1965 is relevant to this discussion of interest rates. Section 427(b) of the law, which prescribes the interest rate on loans federally guaranteed under this program, does introduce a degree of rate flexibility. It states that the maximum rate may not exceed 6 percent, "... except that under circumstances which threaten to impede the carrying out of the purposes..." of the program, the maximum may be raised to 7 percent. This element of flexibility in the maximum rate on guaranteed loans under the federal program would at least cushion the diversion of funds if the 6 percent ceiling became unrealistic. It would seem only prudent for some such provision to be considered under state plans.

The impact of monetary policy may not have too significant an effect on the total flow of borrowed funds supporting students in pursuit of higher education in the early stages of the student loan program. Much more depends, at the moment, upon the speed with which the program can become operational. Also, most major banks are apparently quite ready to allocate some amount of funds for this purpose, in recognition of their public responsibility, and of the longer run advantages of such loans to them. In this regard, the Special Subcommittee on Education of the House of Representatives recently decided not to merge the direct loan program under the National Defense Student Loan Program immediately into the guaranteed loan program authorized in the Higher Education Act of 1965. In supporting this action, Charls Walker of The American Bankers Association stated, "The better course would be for the private sector to concentrate its energies and attention on a successful launching of the guaranteed loan program, and to withhold a decision on the proposed change in the NDEA loan program until the guaranteed private loan program has gained some experience and maturity." However, the more the guaranteed private loan program expands, the more it could feel the changes in credit conditions, whether the changes made conditions tighter or easier.

It should be noted, however, that tight money conditions – whether or not they are further tightened by policy decisions in the interest of society in general – do not work an unmixed hardship on students. The rigors of borrowing funds in the market when a restrictive monetary policy is in effect may be mitigated to some extent by other factors. Money is tightened by the monetary authorities because the economy is operating at such a high level of activity that it threatens to become overheated. This implies that family incomes are rising, and thus the student may find that a lar-

ger part of his expenses may be met out of increased family resources. Then, too, a high level of business activity may result in labor shortages so that more part-time jobs are available. However, as everyone knows, the distribution of prosperity is uneven, at best. There will always be some would-be students seeking an education through borrowed funds and meeting, in the vicissitudes of the market place, numerous obstacles to be overcome.

Tight money bears on educational finance in other ways, as well as in providing loans to students. When credit markets become strained, the funds destined for the construction of the college and university plant may also become less readily available. In inflationary periods, building costs do not hold firm at their earlier levels. Many of the budgets required to construct and equip classrooms and laboratories need to be larger than those conservatively planned before prices began to mount. Some postponements of building projects may be desirable during boom periods, not only from the standpoint of society at large, but also from the standpoint of a limited university budget.

Similarly, during boom times, demand for labor increases. The specialized faculty talent accumulated at universities will often find lucrative opportunities for employment elsewhere. In order to retain, let alone augment, its faculty, the university finds its payroll needs expanding faster than its academic roster. This, too, puts additional strains on the finances of institutions of higher learning.

Thus, educational demands increase the stress on financial markets at the same time that constricting markets increase the difficulty of educational finance. This is a two-way street: swelling requirements for university funds impinge on a tight money market, and vice versa.

This description is one that generally holds for upswings in economic activity. The effects are intensified, however, with the introduction of special programs for student loans. The increase in the number of young men and women of college age, resulting from the "baby boom" of the immediate postwar years, has placed special pressures on universities and colleges to enlarge their faculties and their physical facilities. Add to this the "normal" increase in the percentage of college-age youngsters seeking a higher education, and the extent of the problem becomes apparent. In addition, however, society is undertaking to see that all or most young adults have the opportunity to go to college with financing provided, if necessary, through special credit programs. It is, then, not only a matter of society's generating enough savings to provide for the student loans – whether made directly by the government, directly by the banks, or through a guaranteed loan program – nor is it only an additional matter of providing for normal growth in faculty numbers, in faculty salary levels, and in educational plant. It is also a matter of society's generating the additional savings to finance the further expansion of plant and staff necessitated by the new levels of enrollment increased through the operation of the student loan programs.

The above is in no way meant to suggest that the poor should be deprived of educational opportunity. Quite the reverse. It is simply to point out that the effects of loan programs spill quickly over into additional financial demands, and that it is of the utmost importance to pace an educational expansion program so that society can do an adequate job of implementing it. An attempt to speed up an educational expansion program beyond the capacity of the economy to provide the staff and facilities for the expansion is merely asking for trouble.

One thing should be quite clear: society's efforts to avoid inflation, and to combat incipient inflationary tendencies when they arise, are not undertaken at the expense of education at all, nor do they disfavor education in relation to other parts of American society. These efforts are taken in the interests of hign-

er education as much as in the interests of anything else. Education gains nothing from soaring costs of building school rooms. Rising prices of books and supplies, of laboratory equipment and institutional devices, do not help education. The ability to train the current and coming generations of young people is not advanced by an overheated economy that drains good teachers from that profession. Nor is it easier for the student to go to school when the purchasing power of his own savings and those of his parents diminishes.

Monetary policy is currently tight, necessitating reductions in planned expenditures throughout the economy. It is difficult to forecast what monetary policy will be in the years ahead, because it will depend upon the prevailing state of the economy. Economic growth may proceed at an average rate of, say, 3½ to 4 percent, but the growth rate will probably not be uniform at all times, and monetary policy must shift to fit the situation; sometimes easier and sometimes tighter. The demands for credit from all sectors of the economy may be expected to increase with the growth of the economy, but they must be related to the supply and utilization of physical resources.

In this environment, educational institutions should expect that their success in the financial markets must also share the swings of fortune and that, from time to time, they will feel the influence of a restrictive monetary policy designed in general terms to help stabilize the economy.

If a rising flow of resources over the longer run is to be devoted to higher education, as I am sure everyone will agree is necessary in today's complex world, this can most readily be accomplished in terms of every source and type of funds—government and private; loans, gifts, and payments by students and their families—in an economy in which a high and expanding level of activity continues to be sustained, rather than in an economy subject to recurring periods of boom and depression. Certainly the worst possible outcome would be to have any appreciable number of graduates, facing the prospect of repaying debt incurred during their college years, also face a lack of prospects of earning sufficient income to repay those debts.